

# The Use of Edge Act Corporations Formed under the Laws of the United States of America by Foreign Banks

## I. Introduction

### *Background*

Edge Act Corporations (hereinafter to be referred to as Edge Corporations) are federally chartered corporations organized for the sole purpose of engaging in international or foreign banking or other international or foreign financial operations.<sup>1</sup> Section 25(a) of the Federal Reserve Act,<sup>2</sup> more commonly known as the Edge Act after its sponsor, the late Walter Edge, U.S. senator from New Jersey, authorized the establishment of Edge Corporations in 1919 in order to facilitate the financing of U.S. exports.<sup>3</sup>

Pursuant to the International Banking Act of 1978,<sup>4</sup> (the IBA), foreign banks have for the first time been permitted to establish federally chartered Edge Corporations. The initial policy of the Edge Act has now been supplemented by the IBA to implement a general national policy of parity of treatment between domestic and foreign banking enterprises.<sup>5</sup> Thus, foreign banks now may enter trade markets in the United States through the

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<sup>1</sup>12 U.S.C. § 611.

<sup>2</sup>Act of Dec. 24, 1919, Ch. 18, 41 Stat. 378, codified at 12 U.S.C. §§ 611-632.

<sup>3</sup>9 L. WEERAMANTRY, W. SCHLICHTING, J. COOPER, & J. SEXTON, *BANKING LAW* 213-6 (1981) (hereinafter cited as *Banking Law*), citing H.R. Rep. No. 408, 66th Cong. 18th Sess. 3 (1919).

<sup>4</sup>Pub. L. No. 35-369, 92 Stat. 607 (Sept. 17, 1978). Section 3(c) of the Act amended 12 U.S.C. § 614 to eliminate the requirement that all Edge Corporation directors be U.S. citizens; section 3(f) amended 12 U.S.C. § 619 to permit foreign-owned banking institutions to acquire majority stock control of Edge Corporations, with the approval of the Federal Reserve Board.

<sup>5</sup>S. REP. No. 95-1073, 95th Cong. 2d Sess. reprinted in 1978 U.S. CODE CONG. & AD. NEWS 1421 (hereinafter cited as *Senate Report*).

specialized vehicle of an Edge Corporation.<sup>6</sup>

### *Principal Features*

#### OWNERSHIP

Subject to the approval of the Board of Governors of the Federal Reserve System (the Board), any amount of the stock of an Edge Corporation may be owned by one or more foreign banks,<sup>7</sup> institutions organized under the laws of a foreign country that own or control a foreign bank, or domestic national or state banks that are controlled by a foreign bank or institution that owns or controls a foreign bank.<sup>8</sup> Directors of an Edge Corporation no longer are required to be U.S. citizens.<sup>9</sup> A foreign institution may only invest, in the aggregate, a maximum of 10 percent of its capital and surplus in Edge Corporations.<sup>10</sup>

The Board, in acting on a proposal to organize an Edge Corporation, will consider the following factors: (1) the financial condition and history of the applicant, (2) the general character of its management, (3) the convenience and needs of the community to be served with respect to international banking and financing services, and (4) the effects of the proposal on competition.<sup>11</sup> However, in acting on an application by a foreign institution that is not subject to the IBA or the Bank Holding Company Act,<sup>12</sup> the Board will impose any conditions that are necessary to prevent undue con-

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<sup>6</sup>The IBA additionally contained provisions liberalizing substantive requirements with respect to both domestic and foreign-owned Edge Corporations. These included: (a) the removal of the restrictive leveraging ratio which had prevented Edge Corporations from having liabilities outstanding at any one time upon their debentures, bonds or promissory notes in excess of ten times their paid-in capital and surplus, (b) elimination of the mandatory 10 percent reserve requirement on corporation deposits, and (c) the imposition of the same reserve requirements that apply to member banks. 12 U.S.C. §§ 615(a), 618. Furthermore, in order to implement the purposes and policies of the IBA, Congress directed the Board to revise its regulations governing Edge Corporations to be consistent with the Congressional mandate contained therein. 12 U.S.C. § 611, note. See 44 Fed. Reg. 36,005, eff. June 1, 1979. After only three years of operation, it is safe to conclude that revised Regulation K (12 C.F.R. Part 211) has had a substantial impact on the growing utilization of this financing vehicle. See Special Section on Edge Banking, AM. BANKER, May 24, 1982; April 30, 1981.

<sup>7</sup>A "foreign bank" in this context is defined by the IBA to mean "any company organized under the laws of a foreign country, a territory of the United States, Puerto Rico, Guam, American Samoa, or the Virgin Islands, which engages in the business of banking, or any subsidiary or affiliate, organized under such laws, of any such company. For the purposes of this chapter the term 'foreign bank' includes, without limitation, foreign commercial banks, foreign merchant banks and other foreign institutions that engage in banking activities usual in connection with the business of banking in the countries where such foreign institutions are organized or operating." 12 U.S.C. § 3101(7).

<sup>8</sup>12 U.S.C. § 619, expressly adopting the definition of "control" of the Bank Holding Company Act, 12 U.S.C. 1841(a)(2).

<sup>9</sup>12 U.S.C. § 614.

<sup>10</sup>12 C.F.R. § 211.4(b)(2). For these purposes, "capital and surplus" is defined to mean paid-in and unimpaired capital, and includes undivided profits but does not include the proceeds of capital notes or debentures. 12 C.F.R. § 211.2(b).

<sup>11</sup>12 C.F.R. § 211.4(a)(1).

<sup>12</sup>Such foreign institutions would include those that do not have a branch, agency or commercial lending company in the United States.

centration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices in the United States.<sup>13</sup>

#### CAPITALIZATION

The Edge Act expressly provides that Edge Corporations be organized with an initial capital stock of not less than \$2 million.<sup>14</sup> This requirement in conjunction with the 10 percent capital and surplus investment maximum establishes a condition that a foreign institution must have a minimum of \$20 million of capital and surplus before it becomes eligible to own 100 percent of an Edge Corporation as a subsidiary.

The Board has also imposed a general requirement that an Edge Corporation shall at all times be capitalized in an amount that is "adequate in relation to the scope and character of its activities,"<sup>15</sup> and an Edge Corporation engaged in banking<sup>16</sup> must additionally meet an objective requirement of capital and surplus equal to not less than 7 percent of its "risk assets."<sup>17</sup>

#### PERMISSIBLE ACTIVITIES

The principal limitation of an Edge Corporation is that its business activities be, in the judgment of the Board, incidental to its international or foreign business.<sup>18</sup> The Board has determined that many activities meet this test and has enumerated these permissible activities in Regulation K.<sup>19</sup> However, if an Edge Corporation believes that other activities are incidental to its international or foreign business, it may apply to the Board for permission to engage in such activities.<sup>20</sup>

#### DEPOSITS

An Edge Corporation may receive deposits from foreign governments and their agencies, persons conducting businesses principally abroad,<sup>21</sup> and individuals residing abroad. This class of customer may be further expanded under a current Board proposal, not yet adopted, which would

<sup>13</sup> 12 C.F.R. § 211.4(b)(2).

<sup>14</sup> 12 U.S.C. § 618.

<sup>15</sup> 12 U.S.C. § 211.6(d).

<sup>16</sup> This is to be contrasted with the nonbanking or "investment" Edge Corporations which exist, essentially, as holding companies for foreign investments by domestic institutions. Pursuant to 12 C.F.R. § 211.2(d), an Edge Corporation is "engaged in banking" if it is ordinarily engaged in the business of accepting deposits in the U.S. from nonaffiliated persons.

<sup>17</sup> 12 C.F.R. § 211.6(d). Risk assets include all assets on a consolidated basis other than cash, amounts due from banking institutions in the United States, U.S. government securities and federal funds sold. Effective July 29, 1981, the Board has liberalized Regulation K to provide that subordinated capital notes, in an amount not to exceed 50 percent of nondebt capital, may be included for purposes of determining capital adequacy. 46 Fed. Reg. 39,810 (Aug. 5, 1981).

<sup>18</sup> 12 U.S.C. § 616.

<sup>19</sup> See notes 96-108, *infra*, and accompanying text.

<sup>20</sup> 12 C.F.R. §§ 211.4(e)(5); 211.5(d).

<sup>21</sup> 12 C.F.R. § 211.4(e)(1). Throughout this article "person" shall be defined as either an individual or an organization. See 12 C.F.R. § 211.2(n).

permit the receipt of deposits from certain "qualified customers" who are "principally engaged in international or foreign commerce."<sup>22</sup> The form of deposit has not been restricted and may include demand, savings and time deposits, as well as negotiable certificates of deposit.<sup>23</sup> Deposits may also be received from persons in the United States so long as certain specified criteria relating to the use of these funds internationally are satisfied.<sup>24</sup>

## LOANS

An Edge Corporation may finance certain classes of activities specified in Regulation K,<sup>25</sup> subject to its lending limits.<sup>26</sup> The overriding restriction is that the Edge Corporation must be prepared to prove that the financing transaction is internationally related as per the various requirements of at least one of these categories. An Edge Corporation may additionally acquire participations in or assume obligations arising from transactions which it could have financed initially.<sup>27</sup> As in the case of depositors, the class of eligible borrowers may soon be expanded by the qualified customer proposal.<sup>28</sup>

## GUARANTEES

An Edge Corporation may enter into guarantees if (1) the transaction is related to a permissible financing transaction, (2) the agreement specifies the maximum monetary liability thereunder, and (3) the payments are to be made on the occurrence of readily ascertainable events.<sup>29</sup>

## INCURRENCE OF INDEBTEDNESS

An Edge Corporation may engage in the following types of borrowing transactions: (1) the issuance of obligations to the United States or to domestic offices of other banks, (2) the incurrence of indebtedness from a transfer of direct obligations of, or obligations that are guaranteed by, the United States that the Edge Corporation is obligated to repurchase, and (3) the issuance of certain types of long-term subordinated debt that do not qualify as deposits under Regulation D.<sup>30</sup>

## HOLDING OF FUNDS

An Edge Corporation may only hold or invest funds in the United States which are not currently employed in its foreign business in the form of cash,

<sup>22</sup> See notes 124-130, *infra*, and accompanying text.

<sup>23</sup> 12 C.F.R. § 211.4(e)(1).

<sup>24</sup> 12 C.F.R. § 211.4(e)(2). See notes 100-101, *infra*, and accompanying text.

<sup>25</sup> 12 C.F.R. § 211.4(e)(4)(iv)(v). See notes 102-105, *infra*, and accompanying text.

<sup>26</sup> 12 C.F.R. § 211.6(a), (b), (c). See notes 118-123, *infra*, and accompanying text.

<sup>27</sup> 12 C.F.R. § 211.4(e)(4)(vi).

<sup>28</sup> See notes 22, *supra*, and 124-130, *infra*, and accompanying text.

<sup>29</sup> 12 C.F.R. § 211.4(e)(4)(vii).

<sup>30</sup> 12 C.F.R. § 211.4(e)(4)(i)-(iii). Regulation D consists of 12 C.F.R. Part 204.

deposits with U.S. banks, or money market instruments.<sup>31</sup>

## SECURITIES ACTIVITIES

An Edge Corporation may engage in the securities activities specified in Regulation K. These include: the holding of, or buying or selling of securities for a person; acting as paying agent for securities issued under foreign law; acting as registrar or paying agent for securities issued to finance foreign activities and distributed outside the United States; making private placements of participations in its investments and credit extensions; and providing certain kinds of portfolio and investment advice.<sup>32</sup>

## OTHER ACTIVITIES

An Edge Corporation may receive instruments such as checks, bills, drafts, acceptances, notes, bonds, coupons and securities for collection abroad, and for collection in the United States for a customer abroad,<sup>33</sup> and may buy and sell spot and forward foreign exchange.<sup>34</sup> Under the express terms of the Edge Act,<sup>35</sup> Edge Corporations are forbidden to engage in commerce or trade in commodities. As previously mentioned, an Edge Corporation may always apply to the Board for a determination that any other activity not heretofore discussed is incidental to its international business.<sup>36</sup>

## II. Advantages of an Edge Corporation Over Alternative Means of Foreign Bank Entry Into the United States Market

### *Comparison with Branches and Agencies*

The primary advantage of an Edge Corporation is the relative ease of its establishment. Unlike a federal or state branch or agency operated by a foreign bank, an Edge Corporation, and subsequent domestic branch of such Edge Corporation, may operate an international deposit-taking/banking business through offices in more than one state, once approval of the Board has been obtained.<sup>37</sup> Under the IBA,<sup>38</sup> a foreign bank may, with the

<sup>31</sup> 12 C.F.R. § 211.4(e)(3).

<sup>32</sup> 12 C.F.R. § 211.4(e)(4)(viii)–(xii), (xiv)–(xv). See notes 106–107, *infra*, and accompanying text.

<sup>33</sup> 12 C.F.R. § 211.4(e)(4)(viii).

<sup>34</sup> 12 C.F.R. § 211.4(e)(4)(xiii).

<sup>35</sup> 12 U.S.C. § 617.

<sup>36</sup> See note 20, *supra*, and accompanying text. See, e.g., AM. BANKER, April 30, 1981 (application to buy and sell gold in the U.S. unrelated to foreign business); AM. BANKER, March 17, 1981, at 31 (underwriting of credit life insurance allowed).

<sup>37</sup> 12 C.F.R. § 211.4(c)(1). See Dillion, *Edge Acts Bring Many Advantages to Parent Banks*, AM. BANKER, May 24, 1982, at 15. See also Lehr and McRae, *Foreign Banks in the United States: Acquisitions, Branching, and Other Techniques*, J. COMP. CORP. & SEC. REG. 202, 205 (1981) (survey of alternatives).

<sup>38</sup> 12 U.S.C. § 3102(a). Additionally, a foreign bank may not establish both a federal branch and a federal agency in the same state. 12 U.S.C. § 3102(e).

approval of the Comptroller of the Currency, establish one or more federal branches or agencies in any state in which (1) it is not already operating a branch or agency pursuant to state law and (2) the establishment of a branch or agency by a foreign bank is not prohibited by state law. As of August 31, 1981, only five states have authority to license either foreign bank branches or agencies, four permit branches only, and another nine permit only agencies.<sup>39</sup>

Significantly, among those states that allow both foreign bank branches and agencies, two strategic states, New York and Pennsylvania, impose the additional requirement that the country of the bank's origin reciprocally allow U.S. banks to operate in their country. This severely limits the options available to foreign banks governed by restrictive domestic laws, such as in Colombia, for example. Conversely, other countries, such as Sweden, may even prohibit their own banks from establishing overseas branches. Formation of an Edge Corporation, however, may be more independent of the various restrictions that may exist in other jurisdictions.

Furthermore, assuming that no obstacle exists to the initial U.S. entry of a foreign bank through a federal or state branch or agency, the IBA nevertheless provides that "full-service" federal branches or agencies may only be maintained in the one state which the bank has selected as its "home

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<sup>39</sup>The states which permit both branches and agencies include California, Maine, Massachusetts, New York and Pennsylvania. Illinois, Kentucky, Oregon, and Puerto Rico allow only branches, while Alaska, Florida, Georgia, Hawaii, Louisiana, Maryland, Mississippi, Missouri, and Oklahoma restrict operations to agencies. *Source*: Conference of State Bank Supervisors, Washington, D.C.

Restrictions in Texas, which prohibits both foreign bank branches as well as agencies, and Florida, which permits only agencies, account for the recent surge of Edge Corporation activity in Houston and Miami, respectively. See Cacace, *Foreign Banks Swelling the Edge Act Ranks*, AM. BANKER, May 24, 1982, at 1, 12; Dillon, *supra* note 37 ("Miami Edges, as a result of these capital inflows tend to generate more funds than needed for lending operations and to place the excess with the parent or its offshore offices."). See also (Miami) *International Banking Burgeons in Miami, with Latin American Accent*, AM. BANKER, Jan. 16, 1982, at 2; AM. BANKER, May 28, 1981, at 18; AM. BANKER, May 2, 1981 ("The rapidly expanding number of Edge Act corporations and their branches operating in Miami has been induced not only by expanding internationalism of the city but also by regulatory changes making the Edge Act corporation a more viable entity"); AM. BANKER, May 1, 1981, at 20; AM. BANKER, Sept. 25, 1980, at 2 (Security Pacific New York Edge Corporation opens Miami branch); AM. BANKER, Mar. 20, 1980, at 2; AM. BANKER, Aug. 20, 1979, at 3; AM. BANKER, June 1, 1978 (pre-International Banking Act).

Miami currently has the most Edge Corporations of any city other than New York. However, while the New York offices tend to have a worldwide scope with emphasis on the correspondent banking market (in particular, the providing of Eurodollar clearing services), Miami Edge Corporations focus more on Latin American business, providing services to a broader range of market segments including correspondent banks, governments, corporations and wealthy individuals. After New York and Miami the most favored locations for Edge Corporation offices have been Chicago, Houston, Los Angeles, and San Francisco. Allison, *New York, Miami Edges Show Many Differences*, AM. BANKER, May 24, 1982, at 15.

See also (Houston) AM. BANKER, Dec. 14, 1981, at 17 (Hongkong and Shanghai Banking Corp.); AM. BANKER, Jan. 7, 1981, at 2 (United California Bank); HOUSTON CHRONICLE, Dec. 31, 1980, at 7 (Standard Chartered Bank Ltd. of London); AM. BANKER, Apr. 18, 1979, at 3 (Banque de Paris et des Pays-Bas).

state."<sup>40</sup> With respect to operations outside the "home state," the bank is restricted to "limited" federal branches or agencies which must be expressly permitted by the state in which it is to be operated, and to "limited" state branches or agencies which must be approved by the bank regulatory authority of the state in which it is to be operated.<sup>41</sup> Moreover, a limited federal and state branch must enter into an undertaking with the Board that it shall receive only such foreign-source and international banking and finance-related deposits as would be permissible for Edge Corporations.<sup>42</sup>

In comparison, Regulation K now permits an Edge Corporation virtually unlimited domestic geographic branch expansion.<sup>43</sup> Previously, Edge Corporations were permitted to branch only abroad, and then only with prior Board approval. Thus, in order to provide international banking services at different locations in the United States, U.S. banks were required to incorporate separate Edge Corporations with the concomitant inconvenience and inefficiency of separate capitalization and separate administrations. Indeed, the relative ease of establishing domestic branches of Edge Corporations has been an important factor to many of those foreign banks who have already established Edge Corporations in the U.S.<sup>44</sup> For those banks which intend to operate in more than one state, establishment of an Edge Corporation will provide not only a present vehicle for conducting internationally related business, but will allow them to establish domestic branches with relative ease and thus give them the benefits of regional centers with the potential for unique marketing strategies as well as a foothold presence in the event of a subsequent liberalization of interstate banking restrictions. This ability, to currently establish a market position to cultivate a broader customer base while providing greater operational ease for booking international transactions directly at a local office, should not be underestimated.<sup>45</sup>

Another major advantage of Edge Corporations is that they are explicitly exempt from the operation of the prohibition on nonbanking activities of the Bank Holding Company Act and consequently may invest in foreign

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<sup>40</sup> 12 U.S.C. § 3102(h). A foreign bank may also maintain those "full" branches or agencies that have lawfully been established, or for which an application to commence business had been filed, by July 22, 1978. 12 U.S.C. § 3103(b).

<sup>41</sup> 12 U.S.C. § 3103(a).

<sup>42</sup> See 12 U.S.C. § 3103(a).

<sup>43</sup> 12 C.F.R. § 211.4(c)(1).

<sup>44</sup> For footnote reference, see appendix at —.

<sup>45</sup> See Feghali, *Edge Acts Primary Vehicles for Advancing Foreign Trade*, AM. BANKER, May 24, 1982, at 15 ("branching has accelerated a relative shift in operations from traditional correspondent banking business to the U.S. middle-market and multinational corporations"). Richter, *Edge Branches Can Help Parents Position Themselves For Nationwide Banking*, Special Section on Edge Banking, AM. BANKER, April 30, 1981, at 24 ("the money center banks are seeking to deepen their penetration of the regional markets. At the same time, these actions also help them to prepare for full-service interstate banking when it finally gets the green light from Washington").

nonbank financial institutions.<sup>46</sup> In comparison, the IBA<sup>47</sup> has expressly extended this prohibition on nonbanking activities or investments to foreign banks with a branch bank, agency, or commercial lending company in the United States. While the Bank Holding Company Act does permit a bank to engage or invest in a nonbanking activity that the Board finds "so closely related to banking or managing or controlling banks as to be a proper incident thereto",<sup>48</sup> an Edge Corporation frees a foreign bank from these restrictions provided the activity is otherwise permissible to an Edge Corporation.

As previously discussed,<sup>49</sup> a minimum \$2 million capitalization is required initially for the establishment of an Edge Corporation. However, no separate capitalization requirement is imposed for each Edge Corporation branch. Many U.S. banks have taken advantage of the right to have consolidated capitalizations since the recent introduction of domestic Edge Corporation branching by consolidating their existing Edge Corporations into branches of one parent Edge Corporation, creating a "super-Edge".<sup>50</sup> These reorganizations have afforded additional advantages. Although no separate capitalization would be required in a reorganization (because the

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<sup>46</sup> 12 U.S.C. § 1841(c). Until 1963, Regulation K required a separation of banking and investment Edge Corporations. Most major banks continue to maintain separate entities for these functions although several banking Edge Corporations also serve as investment vehicles to a degree. Unlike bank holding companies, investment Edge Corporations may borrow directly from their parent banks. See Dillion, *supra* note 37. The activities in which an investment Edge Corporation may invest are described in notes 111-112, *infra*, and accompanying text.

<sup>47</sup> 12 U.S.C. § 3106(a).

<sup>48</sup> 12 U.S.C. § 1843(c)(8). The Board has determined that a number of activities, including, for example, trust company activities, certain investment advisory services, data processing, insurance services related to credit extended, courier services for financial instruments, real estate appraisals, and the sale of traveler's checks and U.S. savings bonds, meet the "closely-related" test. 12 C.F.R. § 225.4(a).

<sup>49</sup> See note 14, *supra*, and accompanying text.

<sup>50</sup> See Foorman, *Revised Regulation K: Selected Issues Affecting Banking Edge Corporations*, 1 U. ILL. L. FORUM 41, 43 (1980).

This has been the impetus for a surge of recent reorganizations of domestic Edge Corporations so as to more efficiently employ available capital and benefit from more favorable tax environments in certain states. See, e.g., Cacace, *Regrouping Following Granting of New Powers*, AM. BANKER, April 30, 1981 (eleven major consolidations from April 1980-April 1981); AM. BANKER, April 27, 1981, at 2 (Security Pacific International Bank to add five Edge Corporation branches to its nationwide network); AM. BANKER, Feb. 6, 1981, at 3 (50 percent of applications are for reorganizations of existing corporations in Dallas to Edge Corporation branches); AM. BANKER, Oct. 30, 1980, at 7 (Wells Fargo Bank NA to open Edge Corporation in California which will absorb existing Edge Corporations in New York and Miami and allow new international branches to be opened outside of California; key was "utilization of same capital base"); Wiegold, *Banks Planning National Moves*, AM. BANKER, Nov. 14, 1979 (major expansion and consolidation by Citibank planned; will center activities of nationwide branches in Miami for operating efficiency); Carson, *Bank of America to have Edge Branches Open by Yearend*, AM. BANKER, July 31, 1980, at 1 (Bank of America to embark on reorganization of seven new branches and form existing Edge Corporations under California based parent).

Foreign branches have not pursued this course of action since they have only recently been allowed to establish any Edge Corporations at all. However, this still remains a viable alternative for them in the future if in fact separate Edge Corporations rather than branches had initially been established in the United States.



existing Edge Corporations were established with an independent capital structure) their subsequent consolidation would inevitably increase the capital base of the parent Edge Corporation and, thus, increase its lending and acceptance limits<sup>51</sup> to individual customers. With respect to foreign Edge Corporation branches which may be established in the future without separate capitalization, lending and acceptance limits may be increased, in effect, through the sale of participation interests to affiliated Edge Corporations.

In comparison, under the IBA, the restrictions and limitations based on the capital and surplus of a federal branch or agency of a foreign bank are measured against the capital and surplus of the foreign bank itself, and not the individual branch or agency as would be the case for domestic national banks.<sup>52</sup> However, while a branch or agency might have this advantage over an Edge Corporation, it must be remembered that the purpose of the Edge Corporation would be to engage in international trade so that a relatively lower lending limit may not be as great an obstacle as it may initially appear in the context of the limited market in which the Edge Corporation would operate.

An Edge Corporation may also be desirable because it enables a foreign bank to avoid the deposit requirement applicable to federal branches or agencies of foreign banks. Under the IBA,<sup>53</sup> a foreign bank that establishes a federal branch or agency must maintain a capital equivalency deposit with a Federal Reserve member bank equal to the larger of the initial capital of a national bank at that location or 5 percent of the branch or agency's liabilities. The foreign bank additionally is required to hold assets in each state in which it operates, the type and amounts of which are to be prescribed by the Comptroller of the Currency and may vary from state to state.<sup>54</sup> An Edge Corporation would not be subject to any similar requirements. However, federal branches and agencies and Edge Corporations<sup>55</sup> are both subject to the reserve requirements of Regulation D.<sup>56</sup> State branches and agencies are governed in this area by the respective laws of the state in which they operate.

With respect to restrictions on the taking of deposits, an Edge Corporation will differ from a full federal or state branch in that the Edge Corporation is only permitted to accept deposits which relate to international finance.<sup>57</sup> However, this advantage runs only in favor of a full federal or state branch in the foreign bank's designated "home state", because as pre-

<sup>51</sup> See notes 118-123, *infra*, and accompanying text.

<sup>52</sup> 12 U.S.C. § 3102(b). The business transacted by all of a foreign bank's branches and agencies will be aggregated in determining compliance. *Id.*

<sup>53</sup> 12 U.S.C. § 3102(g)(1)(2); 12 C.F.R. § 28.6.

<sup>54</sup> 12 U.S.C. § 3102(g)(4); 12 C.F.R. § 28.9.

<sup>55</sup> 12 U.S.C. § 3105(a) (if the parent foreign bank has, or is controlled by a foreign company which has, total worldwide consolidated bank assets in excess of \$1 billion); 12 U.S.C. § 615(a).

<sup>56</sup> 12 C.F.R. Part 204.

<sup>57</sup> See notes 21-24, *supra*, and notes 100-101, *infra*, and accompanying text.

viously discussed,<sup>58</sup> any interstate branch would necessarily be restricted to accepting the same types of deposits as an Edge Corporation. As compared with an agency, an Edge Corporation would have broader deposit accepting powers, since an agency, by definition,<sup>59</sup> is restricted to accepting deposits only from nonresidents and noncitizens of the United States, as well as "credit balances" incidental to their banking powers.

With regard to relative ease of administrative compliance, only full federal branches which receive deposits of less than \$100,000 must obtain FDIC insurance.<sup>60</sup> There is no similar requirement for agencies or for Edge Corporations. Also, while Edge Corporations, branches and agencies are subject to examination by the Board, all branches, agencies, and commercial lending companies must submit an extensive Annual Report.<sup>61</sup> Edge Corporations must file less detailed reports of conditions twice each year.<sup>62</sup>

### *Comparison with National or State Subsidiary Banks*

Unlike federal and state branches and agencies which are considered part of the foreign bank, national or state subsidiary banks are independent entities, chartered under federal or state law, whose shares are owned by the foreign bank. Consequently, the foreign bank will become classified as a bank holding company because it has control over another bank<sup>63</sup> and, as such, become subject to the provisions of the Bank Holding Company Act.

A federal charter may be obtained pursuant to the National Bank Act, which subjects national banks to the regulations of the Comptroller of the

<sup>58</sup>See note 42, *supra*, and accompanying text.

<sup>59</sup>12 U.S.C. § 3101(1); 12 C.F.R. § 28.2(b). This restriction is in fact very similar to the restrictions on deposits of Edge Corporations prior to the revision of Regulation K. See former 12 C.F.R. § 211.7(c).

<sup>60</sup>12 U.S.C. § 3104(a). "FDIC" is the abbreviation for the Federal Deposit Insurance Corporation, which was created during the economic and banking crisis of the early 1930s to promote sound banking practices and to protect bank deposits through deposit insurance. Limited federal or state branches are explicitly exempted from mandatory insurance. 12 U.S.C. § 3103(a). Full state branches which receive deposits of less than \$100,000 must obtain FDIC insurance if the laws of that state would require a bank organized under its laws to be insured. 12 U.S.C. § 3104(b).

<sup>61</sup>Form F.R. Y-7, 46 Fed. Reg. 12,110 (Feb. 12, 1981).

<sup>62</sup>12 U.S.C. § 625, 12 C.F.R. § 211.7(b), (c)(1). The focus of their examination is somewhat different than in the examination of commercial banks. Emphasis is given to assuring that the Edge Corporation respects the limitations of its franchise by engaging in only those activities permissible under Regulation K (that is, credit extensions must be internationally related, regardless of the residence of the borrower, while with respect to deposit-taking activities, foreign residence may be a determinant). Compliance with Regulation D (12 C.F.R. Part 204, Reserves on Deposits) and Regulation Q (12 C.F.R. Part 217, Interest on Deposits) is also monitored. Dillion, *supra* note 37.

<sup>63</sup>12 U.S.C. § 1841(a)(1). One of the principal objectives of the Bank Holding Company Act is to prevent the lessening of competition in the banking business and thus, bank acquisitions of banks are strictly regulated. 12 U.S.C. § 1842. Additionally, the combination of banking as well as nonbanking activities under single control is generally prohibited. See notes 46-48, *supra*, and accompanying text. There are also extensive reporting requirements. 12 U.S.C. § 1844.

Currency.<sup>64</sup> While there are no limits on the foreign ownership of the equity of national banks, non-U.S. citizens may not comprise a majority of the Board of Directors.<sup>65</sup> National banks are required to become members of the Federal Reserve System and are extensively regulated by the Board.<sup>66</sup> They are also required to obtain FDIC insurance, and certain of their operations fall within the regulatory control of the FDIC.<sup>67</sup> In all other respects, federal branches and agencies are, except as otherwise provided in the IBA, subject to the same duties, restrictions, penalties, liabilities, conditions and limitations that would apply to a national bank doing business at the same location.<sup>68</sup> Some local foreign laws, however, may prohibit a foreign bank's investment in a U.S. subsidiary. Additionally, while the powers of subsidiaries are not limited to internationally related activities, the capital costs associated with their acquisition may in some cases be much greater than those involved in the establishment of an Edge Corporation.

State subsidiary banks are chartered under state law and subject to the varying restrictions and regulations of, and examination by, the respective states. These banks may be required to secure FDIC insurance<sup>69</sup> in which case they would become subject to the FDIC's regulations. They also have the option of becoming member banks of the Federal Reserve System,<sup>70</sup> and if such option were exercised, they would become subject to all those regulations as well. Thus, while national and state subsidiary banks clearly allow a foreign bank the greatest latitude to engage in banking activities, they are subject to much more extensive regulation than is imposed upon Edge Corporations.

### *Comparison with Commercial Lending Companies*

A commercial lending company is a state-chartered corporation which may maintain credit balances and make commercial loans<sup>71</sup> of an international and wholesale nature. The term commercial lending company as used in the IBA<sup>72</sup> is intended to refer to an entity similar to a New York investment company<sup>73</sup> which is able to borrow and lend money, accept bills of exchange, issue letters of credit, act as a financial agent of the U.S. government, and invest in stocks of a corporation. It was included in the IBA to ensure that the requirements imposed on agencies cannot be evaded

<sup>64</sup> 12 U.S.C. § 21, 12 C.F.R. § 1.

<sup>65</sup> 12 U.S.C. § 72.

<sup>66</sup> 12 U.S.C. § 221; 12 C.F.R. § 201, *et seq.*

<sup>67</sup> 12 U.S.C. § 1814(b); 12 C.F.R. § 300, *et seq.*

<sup>68</sup> For example, a subsidiary's lending limits are based on its own capital and surplus while a federal branch or agency may rely on that of its parent. Federal branches and agencies, unlike national banks, are not required to become Federal Reserve member banks.

<sup>69</sup> 12 U.S.C. § 1815.

<sup>70</sup> 12 U.S.C. § 321.

<sup>71</sup> 12 U.S.C. 3101(9).

<sup>72</sup> See Senate Report, *supra* note 5, at 1423.

<sup>73</sup> N.Y. Banking Law § 508, *et seq.*

through the incorporation or acquisition of such corporations. An Edge Corporation clearly may engage in a broader range of activity provided that such activity is internationally related.

A commercial lending company is subject to the Bank Holding Company Act's prohibition on nonbanking activities, but, like a foreign branch or agency, it is not otherwise deemed a Bank Holding Company.<sup>74</sup> Commercial lending companies may be converted, with the approval of the Comptroller of the Currency, to a federal branch or agency,<sup>75</sup> as may state branches and agencies.

### *Comparison with Representative Offices*

A representative office is the simplest form of foreign bank entry into the United States. Such U.S. offices of foreign banks conduct no "active" business; they may only solicit loans, act as a liaison with correspondent banks, and engage in customer public relations. They are relatively inexpensive to operate and should adverse economic conditions develop, a vacated representative office may not reflect negatively on the parent.<sup>76</sup> The IBA requires that such an office be registered with the secretary of the treasury.<sup>77</sup> A few states additionally may require notification or registration as well.

Thus, it appears that the alternatives available to foreign banks which intend to establish a U.S. presence are either more limited in scope, or are subject to restrictions which render them less suitable vehicles for entry than Edge Corporations, especially as Regulation K continues to be liberalized.

### **III. Disadvantages**

The major disadvantage of an Edge Corporation is that its activities must be internationally related. However, this may not be an important consideration for a foreign bank since foreign-oriented business is likely to be its primary goal in the establishment of a U.S. presence.

Another possible disadvantage is the fact that the foreign bank, as previously discussed,<sup>78</sup> must have a capital and surplus of at least \$20 million before it becomes eligible to own 100 percent of an Edge Corporation as a subsidiary. However, due to the availability of consolidation,<sup>79</sup> an Edge Corporation and its branches may be organized pursuant to one initial investment of \$2 million.

Finally, Edge Corporations are subject to various restrictions on the amounts and types of loans and acceptances which it may make. For

<sup>74</sup> 12 U.S.C. § 3105(a); 12 U.S.C. § 1843.

<sup>75</sup> 12 U.S.C. § 3102(f).

<sup>76</sup> Hablutzel and Lutz, *Foreign Banks in the United States after the International Banking Act of 1978: The New Dual System*, 96 BANKING L.J. 133 (1979).

<sup>77</sup> 12 U.S.C. § 3107(a); 31 C.F.R. §§ 123.1, 123.2.

<sup>78</sup> See note 14, *supra*, and accompanying text.

<sup>79</sup> See notes 49-51, *supra*, and accompanying text.

example, Edge Corporations engaged in banking are required to maintain a capital-to-risk asset ratio of no less than 7 percent and, with certain exceptions, may not extend credit to any one person in excess of 10 percent of the Edge Corporation's capital and surplus. This generally prevents booking of large size credits for major public, bank or corporate customers and requires Edge Corporations to sell portions of such credits to other banks. Thus, many banking Edge Corporations have specialized in off-balance sheet services, such as documentary credits, collections and foreign exchange. The details of these limitations will be discussed below.<sup>80</sup>

#### IV. Formation of an Edge Corporation

##### *Application*

Foreign banks that seek to organize an Edge Corporation or to acquire a majority of shares of an existing Edge Corporation may file an application in letter form with the Federal Reserve bank of the district in which the foreign bank's U.S. banking activities are principally conducted. If the applicant bank is not currently conducting banking activities in the United States, it must file an application with the Federal Reserve bank of the district in which the Edge Corporation is, or is to be, located. The Board's internal guidelines for information required to be supplied by foreign banks, which are more extensive than what is required by Regulation K, include whatever is normally required for domestic Edge Corporation licenses as well as data derived from form F.R. Y-7.<sup>81</sup>

Additionally, a banking institution principally engaged in foreign business, incorporated under the laws of any state of the United States, having an unimpaired capital sufficient to entitle it to become an Edge Corporation, may, by a vote of shareholders owning not less than two-thirds of its capital stock, be converted into an Edge Corporation with the consent of the Board, so long as such conversion would not contravene state law.<sup>82</sup>

##### *Mechanics*

Edge Corporations may be organized by five or more natural persons.<sup>83</sup> They must adopt articles of association specifying in general terms the objects for which the Edge Corporation is to be formed and containing any

<sup>80</sup> See notes 118-123, *infra*, and accompanying text. See also notes 15-17, *supra*, and accompanying text; Feghali, *supra* note 45 (On the other hand, "trade financing through banker's acceptances may be extended to a customer in excess of the legal lending limit through participation of the customer risk to other banks, typically its parent bank.")

<sup>81</sup> Form Y-7, adopted in 46 Fed. Reg. 12,110 (1981), is the standard Annual Report of Foreign Banking Organizations for those foreign banks with U.S. operations conducted through branches, agencies and commercial lending companies. See McPheter, *Formation of Edge Act Corporations by Foreign Banks*, 37 Bus. Law. 593 (1982), at 600-11, for a comprehensive discussion of the mechanics of this application process.

<sup>82</sup> 12 U.S.C. § 629.

<sup>83</sup> 12 U.S.C. § 611.

other provisions not inconsistent with the law.<sup>84</sup> These articles must then be forwarded to the Federal Reserve Board for acceptance and filing. An organization certificate must also be executed and acknowledged. The Board, upon approval of an application, will issue a preliminary permit.<sup>85</sup> Until a final permit to commence business is issued,<sup>86</sup> the Edge Corporation may only elect officers, complete its organization, invest in U.S. government obligations, and maintain deposits with banks.<sup>87</sup> Edge Corporations have all standard corporate powers except that their corporate existence is limited to 20 years plus extensions.<sup>88</sup>

### *Minimum Capital Stock Requirement*

One quarter of the minimum capital stock requirement of \$2 million<sup>89</sup> must be paid in before a final permit will issue. The remainder must be contributed in installments of at least 10 percent of the total amount every two months from the time business commences. Shareholders are liable for the amount of their unpaid stock subscription.<sup>90</sup> The capital stock of any Edge Corporation may be increased at any time, with the Board's approval, by a vote of two-thirds of the shareholders at a meeting or the unanimous consent of all of the shareholders, so long as the increase is fully paid within 90 days of such approval. Capital stock may be reduced in a similar manner but in no event below \$2 million. Capital may not be withdrawn in the form of dividends or otherwise.<sup>91</sup>

### *Reporting Requirement*

Edge Corporations are required to make semi-annual reports of condition to the Board and to be examined once each year. The acquisition or disposition of Edge Corporation shares must be reported within 30 days from the event in question. Reports with respect to the foreign operations of the Edge Corporation may also be required.<sup>92</sup>

### *Establishment of Branches*

Edge Corporations may establish branches in foreign countries not speci-

<sup>84</sup> 12 U.S.C. § 612.

<sup>85</sup> 12 U.S.C. § 614.

<sup>86</sup> Since December 30, 1981, a regional Federal Reserve Bank may issue a final permit. 46 Fed. Reg. 2,027 (Jan. 8, 1981).

<sup>87</sup> 12 C.F.R. § 211.4(a).

<sup>88</sup> 12 U.S.C. §§ 614, 628. Standard corporate powers include, inter alia, the power to adopt and use a corporate seal, to make contracts, to sue and be sued, to elect or appoint directors and officers, and to prescribe bylaws.

<sup>89</sup> 12 U.S.C. § 618.

<sup>90</sup> 12 U.S.C. § 621. Share certificates cannot be denominated as no-par value shares. 12 C.F.R. § 211.4(b)(1).

<sup>91</sup> 12 U.S.C. § 618. However, dividends may be declared semiannually out of the net profits of the corporation. See 12 U.S.C. § 626.

<sup>92</sup> 12 U.S.C. § 625; 12 C.F.R. § 211.7(b), (c).

fied in the original organization certificate.<sup>93</sup> The procedures followed are the same as those applicable to the establishment of foreign branches by Federal Reserve member banks.<sup>94</sup>

An Edge Corporation may also now establish branches anywhere in the United States upon (1) prior notification to the appropriate Federal Reserve Bank and (2) publication of notice of the proposal in a newspaper of general circulation in the geographic area of the proposed branch. If the Federal Reserve Bank receives no adverse comment in response to the notice, finds that the proposal would be consistent with the factors applicable to the formation of an initial Edge Corporation,<sup>95</sup> and believes that the proposal raises no significant policy issues on which the Board has not previously expressed its view, the Edge Corporation may establish the branch 45 days after the Federal Reserve Bank has received the notification.

## V. A Brief Summary of Regulation K

### *Activities*

Federal Reserve Board Regulation K enumerates the rules governing the operations of Edge Corporations. In its revision of Regulation K in response to the mandate of the IBA, the Board has specified those activities, in addition to those that are expressly set forth in the Edge Act,<sup>96</sup> which will ordinarily be considered incidental to such a corporation's international or foreign business.<sup>97</sup> The major banking powers of Edge Corporations are expressly enumerated in the Edge Act and include the following:

1. to purchase, sell, discount and negotiate notes, drafts, checks, bills of exchange, acceptances, cable transfers and other evidences of indebtedness;
2. to purchase and sell securities, including obligations of the United States or of any state, but not including shares of stock in any corporation except as provided in the Edge Act;
3. to accept bills or drafts drawn upon it;
4. to issue letters of credit;
5. to purchase and sell coin, bullion, and exchange;
6. to borrow and lend money;
7. to issue debentures, bonds, and promissory notes;
8. to receive deposits outside of the United States and to receive only such deposits within the United States as may be incidental to, or for the purpose of, carrying out transactions in foreign countries or dependencies or insular possessions of the United States, and to generally

<sup>93</sup> 12 U.S.C. § 615(b).

<sup>94</sup> 12 C.F.R. § 211.4(c)(2). See 12 C.F.R. § 211.3(a).

<sup>95</sup> 12 C.F.R. § 211.4(c)(1). See 12 C.F.R. § 211.4(a)(1). Note that 12 C.F.R. § 265.2(a)(3) allows the Board to delegate its authority in this regard to the Federal Reserve Banks.

<sup>96</sup> 12 U.S.C. § 615.

<sup>97</sup> 12 C.F.R. § 211.4(e).

exercise those powers incidental to the above, in connection with the transaction of banking or other financial operations.<sup>98</sup>

The safeharbor listing of activities in the United States permissible under Regulation K<sup>99</sup> is fairly extensive, and includes the following activities with respect to deposits and use of funds:

1. to receive demand, savings,<sup>100</sup> and time deposits from foreign governments, persons conducting business primarily at their offices or establishments abroad, and individuals residing abroad;
2. to receive such deposits from other persons if these deposits are to be transmitted abroad or are to be used for the payment of obligations of the Edge Corporation, or consist of the proceeds of collections abroad that are to be used to pay for exported or imported goods or for other such costs of trading goods, or are the proceeds of extensions of credit by the Edge Corporation or represent compensation to the Edge Corporation for extensions of credit and services to the customer; and
3. to hold or invest funds in the United States not currently employed in the Edge Corporation's international or foreign business, which must be in the form of cash, bank deposits and money market instruments.<sup>101</sup>

An Edge Corporation may also engage in the following "general activities"<sup>102</sup> to the extent consistent with sound banking practices (subject to its lending limits and capital requirements):<sup>103</sup>

1. issue obligations to domestic offices of other banks or to the United States or any of its agencies;

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<sup>98</sup>The IBA amended this statutory section in order to maintain competitive parity between Edge Corporations and domestic and foreign banks by removing the previous limits on liabilities (including debentures, bonds and promissory notes) and eliminating special reserve requirements. However, the right of the Board has been preserved to promulgate rules of limiting liabilities of any and all classes, and outstanding at one time. At the present time, no such limits have been imposed, and it is unlikely that they will be in the future in light of the policy behind Section 3 of the International Banking Act. See *BANKING LAW*, *supra* note 3, at 213-21.

<sup>99</sup>12 C.F.R. §§ 211.4(e)(1), (2), & (3).

<sup>100</sup>Regulation K was expanded here to permit savings deposits. See former 12 C.F.R. § 211.7(c). This enables Edge Corporations whose customer base includes many foreign individuals to provide more complete banking services.

<sup>101</sup>Previously, Regulation K only allowed funds to be held in the form of cash, deposits with banks, banker's acceptances, and federal or municipal bonds. Former 12 C.F.R. § 211.7(b). The revised list enhances the Edge Corporation's flexibility in investing funds at current market rates. One commentator has predicted that this should serve to increase profitability, reduce asset management problems and make the Edge Corporation a more desirable vehicle for smaller bank activity. Kelly, *Edge Act Corporations After the International Banking Act and New Regulation K: Implications for Foreign and Regional or Smaller Banks*, 20 VA. J. INT'L LAW 37, 53 (1979).

<sup>102</sup>12 C.F.R. § 211.4(e)(4).

<sup>103</sup>See 12 C.F.R. § 211.6; see also notes 118-123, *infra*, and accompanying text.



2. incur indebtedness from a transfer of direct obligations of, or obligations fully secured by, the United States or any of its agencies, that the Edge Corporation is obligated to repurchase;
3. issue long-term subordinated debt that does not qualify as a deposit under Regulation D;
4. finance: (a) contracts, projects, or activities performed substantially abroad;<sup>104</sup> (b) the importing and exporting of goods into and from the United States; (c) the domestic shipment or temporary storage of such goods; (d) the assembly or repackaging of such goods; and (e) the costs of production of goods and services for which export orders have been received or which are identifiable<sup>105</sup> as being directly for export.

An Edge Corporation may also:

1. assume or acquire participations in extensions of credit or obligations arising from transactions which the Edge Corporation would have been permitted to finance itself;
2. guarantee a customer's debts or otherwise agree to make payments on the occurrence of readily ascertainable events if the maximum amount of its liability is specified and the transaction is one which the Edge Corporation could have financed;
3. receive instruments for collection abroad and collect such instruments in the United States for a customer abroad;
4. hold securities in safekeeping or purchase or sell securities upon the order and for the account of a person;<sup>106</sup>
5. act as paying agent for securities issued by foreign governments or entities organized under foreign law;
6. act as trustee, registrar, or conversion or paying agent with respect to any class of securities issued to finance foreign activities and distributed solely outside the United States;
7. make private placements of participations in its investments and extensions of credit (but not sell or distribute securities in the United States other than to the extent permitted to member banks under 12 U.S.C. § 24, the National Bank Act); and
8. purchase and sell spot and forward foreign exchange.

<sup>104</sup>The new Regulation K added "substantially" to this context. See former 12 C.F.R. § 211.7(d)(1)(i). Thus, Edge Corporations must no longer ensure that the *entire* activity financed took place abroad.

<sup>105</sup>The new Regulation K includes the concept of goods "identifiable as being directly for export." See former 12 C.F.R. § 211.7(d)(1)(iv). This now provides for a "working capital/production" financing for domestic business. Previously, Edge Corporations were only permitted to finance the export or import sale and the transportation directly related thereto. However, the burden still remains on the Edge Corporation to confirm that the goods or services produced will be for export only. See Foorman, *supra* note 50, at 53-4; Cobb, *A Shot in the Arm for Edge Act Corporations*, 97 BANKING L.J. 236, 240 (1980).

<sup>106</sup>The requirement of a "customer abroad", former 12 C.F.R. § 211.7(d)(6), has been deleted.

Most recently, Regulation K has been liberalized to allow Edge Corporations to do the following:

1. act as investment or financial adviser by providing portfolio investment advice and portfolio management with respect to securities, other financial instruments, real property interests and other investment assets,<sup>107</sup> provided such services for United States persons shall be with respect to foreign assets only, and
2. provide general economic information and advice, general economic statistical forecasting services and industry studies, as long as such services for United States persons are with respect to foreign economies and industries only.

These new activities are a logical extension of the Edge Corporation's ability to hold, buy, and sell securities for the account of a person. This business has traditionally been handled by investment banking firms in such places as New York and London and Edge Corporations will now be able to compete in these areas.

As previously discussed,<sup>108</sup> if any Edge Corporation believes that any other U.S. activities would be incidental to its international or foreign business, it may apply to the Board for permission to engage in such activities.

### *Investments in Other Organizations*

The substantive limitations on the purchase of stock by an Edge Corporation in other corporations may be found initially within Section 615(c) of the Edge Act itself.<sup>109</sup> Pursuant to this provision, an Edge Corporation may, with the consent of the Board, purchase and hold shares of stock in any foreign or domestic corporation as long as any of the business that may be transacted by such companies in the United States is incidental to such corporation's international or foreign business.<sup>110</sup> Such corporations, however, may not be engaged in the general business of buying or selling goods, wares, merchandise, or commodities in the United States except as may, in the judgment of the Board, be incidental to their international or foreign

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<sup>107</sup>For purposes of this section, 12 C.F.R. § 211.4(e)(4)(xiv), management of an investment portfolio does not include operational management of real property, industrial and commercial assets. 46 Fed. Reg. 50,975 (Oct. 16, 1981) (proposed), adopted Mar. 12, 1982 (purpose to accommodate wealthy individuals residing outside the U.S. who visit infrequently). *See also* Feghali, *supra* note 45 ("Edges can now perform a number of noncredit services including merger and acquisition assistance, cash management, foreign exchange business and automatic investment accounts"); McCormick, *Fed. Approves Expanded Activities for Edge Firm*, AM. BANKER, Mar. 11, 1982, at 3 (counseling to parallel that of trust department).

<sup>108</sup>*See* note 36, *supra*, and accompanying text.

<sup>109</sup>12 U.S.C. § 615(c).

<sup>110</sup>An Edge Corporation may also, with the consent of the Board, invest in a foreign company that does business in the United States if (1) the company is "predominantly" engaged in foreign business or in internationally related domestic business, (2) the domestic activities are banking or "closely related to banking", and (3) the Edge Corporation owns less than 25 percent of the voting stock and otherwise does not control the foreign company. *See* 46 Fed. Reg. 8,437 (Jan. 19, 1981), 12 C.F.R. § 211.602 (Board Interpretation).

business. Additionally, investment in any one organization is limited to 10 percent of the Edge Corporation's capital and surplus and to 15 percent in the case of investments in banking corporations, unless the approval of the Board is otherwise obtained.

Revised Regulation K<sup>111</sup> states a general policy that activities of Edge Corporations abroad shall be confined to those of a banking and financial nature, in accordance with high standards of banking or financial prudence. Investments are now categorized as those in subsidiaries, joint ventures, or portfolio investments, according to the percentage of equity owned by the Edge Corporation.<sup>112</sup> The Board has given its "general consent" to investments as long as the entity is not engaged in business in the United States and the total amount invested does not exceed the lesser of \$2 million or 5 percent of the capital and surplus of an Edge Corporation engaged in banking, or 25 percent of the capital and surplus of an Edge Corporation not engaged in banking.<sup>113</sup> The Edge Corporation must give 45 days "prior written notification"<sup>114</sup> of investments not qualifying for general consent but still amounting to less than 10 percent of the Edge Corporation's capital, or receive "specific consent" for anything that does not fall within either of these other two categories.<sup>115</sup> Again, the Board has listed activities that it deems to be "usual" in connection with the transaction of banking or other financial operations abroad,<sup>116</sup> and an investor Edge Corporation may apply to the Board for a determination as to the qualification of any other activity.

Finally, an Edge Corporation is not permitted ownership in any other Edge Corporation or domestic business corporation with which, or which hold stock in corporations with which, it is in substantial competition. However, the above limits do not prohibit an Edge Corporation from purchasing stock in any corporation if such purchase is necessary in order to prevent a loss upon a debt previously contracted in good faith, so long as such stock is disposed of within six months.<sup>117</sup>

<sup>111</sup> 12 C.F.R. § 211.5, amending former 12 C.F.R. § 211.8.

<sup>112</sup> See 12 C.F.R. §§ 211.2(k)(o)(p) (*subsidiary*—controlling ownership; *joint venture*—20–50 percent; *portfolio*—less than 20 percent). A joint venture may have no more than 10 percent of its assets or revenues attributable to impermissible activities, while portfolio investments engaged in business activities impermissible to a joint venture may not exceed 100 percent of the Edge Corporation's equity capital. 12 C.F.R. § 211.5(b)(1).

<sup>113</sup> 12 C.F.R. § 211.5(c)(1)(i). Additional investments are allowed pursuant to certain specifications. 12 C.F.R. § 211.5(c)(1)(ii)–(iv).

<sup>114</sup> 12 C.F.R. § 211.5(c)(2). Since December 30, 1980, the Board may waive this period. 46 Fed. Reg. 2,027 (Jan. 8, 1981).

<sup>115</sup> 12 C.F.R. § 211.5(c)(3).

<sup>116</sup> 12 C.F.R. § 211.5(d). These include: commercial banking, financing, leasing property, acting as a fiduciary, underwriting credit, life, health and accident insurance, providing investment, financial, or other economic advisory services, general insurance brokerage, data processing, and underwriting debt and equity securities outside the United States pursuant to certain limitations on amount.

<sup>117</sup> 12 U.S.C. § 615(c).

*Lending and Acceptance Limits*

Revised Regulation K limits the direct or indirect liabilities to an Edge Corporation engaged in banking of any one person to 10 percent of its capital and surplus.<sup>118</sup> The liabilities which are subject to this limitation are defined to include:

1. ineligible acceptances outstanding;
2. obligations for money borrowed;
3. investments in another organization other than direct or indirect subsidiaries;
4. unsecured obligations resulting from the issuance of guarantees;
5. underwriting commitments to an issuer of securities;
6. obligations of members of partnerships;
7. obligations for the benefit of a corporation that are incurred by another corporation it controls; and
8. the liabilities of foreign government departments deriving current funds principally from general tax revenues.<sup>119</sup>

The regulation also provides several exceptions to those rules:

1. deposits of banks and federal funds purchased;
2. bills or drafts drawn in good faith against actual goods and on which two or more parties are liable;
3. any acceptance that has not matured and is not held by the acceptor;
4. obligations to the extent secured by cash collateral;
5. obligations to the extent supported by the full faith and credit of the United States or any of its departments; and
6. obligations to the extent supported by any organization if at least 25 percent of such obligation or of the total credit is supported by the full faith and credit of the United States and any of its departments such that default to the lender will necessarily include default to that organization.<sup>120</sup>

With respect to acceptances of Edge Corporations, the Board wished to provide greater freedom of operation and thus removed the previous requirement that the Edge Corporation remain fully secured to the extent of 50 percent of all acceptances outstanding in excess of capital and surplus.<sup>121</sup>

<sup>118</sup> 12 C.F.R. § 211.6(b). Prior to the revision of Regulation K, Edge Corporations engaged in banking could not lend to one person an amount greater than 10 percent of its capital and surplus while an Edge Corporation not engaged in banking was limited to 50 percent. See former 12 C.F.R. § 211.9(b). The Board believed that the new arrangements would best serve the purposes of lending limits, although most of the comments it received opposed the proposal as being unduly restrictive. 44 Fed. Reg. 36,007 (June 20, 1979).

<sup>119</sup> 12 C.F.R. § 211.6(b)(2).

<sup>120</sup> 12 C.F.R. § 211.6(b)(3).

<sup>121</sup> See former 12 C.F.R. § 211.9(a). An acceptance was, and still is, excluded, however, to the extent that the excess represented the international shipment of goods and the Edge Corporation was fully covered by bank guaranteed primary obligations.

An Edge Corporation is now required to remain fully secured with respect to:

1. all acceptances in excess of twice its capital and surplus, and
2. all acceptances for any one person in excess of 10 percent of its capital and surplus.<sup>122</sup>

In addition, revised Regulation K now exempts such acceptances if the Edge Corporation is fully covered by participation agreements from other banks.<sup>123</sup>

## VI. Outlook for the Future

### *The "Qualifying Customer"*

One of the more controversial proposed revisions<sup>124</sup> to Regulation K, that of the "qualifying customer," has yet to be finalized and is still open for consideration. This provision would have permitted Edge Corporations to accept deposits from and extend credit to persons "principally engaged in international or foreign commerce." This status would be presumed if two-thirds of such persons' purchases or sales of goods and services were directly attributable to international or foreign commerce.<sup>125</sup>

The final version of Regulation K,<sup>126</sup> however, did not include this category, as the information submitted during the comment period was deemed insufficient for the Board to assess its effects.<sup>127</sup> Action was thus deferred and a new proposal was to issue after further consideration. A statement that the Board is due to reconsider the proposal was, in fact, published on April 1, 1981, again on October 1, 1981, and again on April 1, 1982,<sup>128</sup> referring essentially to the earlier version.

At the present time, the "full services to qualifying customers" remains a

<sup>122</sup>12 C.F.R. § 211.6(a)(1). These two requirements were unchanged from former 12 C.F.R. § 211.9(a).

<sup>123</sup>12 C.F.R. § 211.6(a)(1)(ii).

<sup>124</sup>See 44 Fed. Reg. 10,509 (Feb. 21, 1979).

<sup>125</sup>"The staff proposed the concept in order to increase competition by permitting Edge Corporations to offer both trade-related and other services to a limited group, reduce the number of customers whose deposit and credit transactions would have had to have been monitored on a transaction by transaction basis, and promote a greater efficiency by allowing some firms engaged in international trade to have their financial needs met by a single institution." Cobb, *supra* note 105, at 244.

<sup>126</sup>See 44 Fed. Reg. 36,006 (1979).

<sup>127</sup>In fact, in May 1979, the Board questioned the two-thirds guideline and ordered the Staff to revise it; they presented a recommendation to qualify customers which have three-quarters of their costs or revenues attributable to international commerce, but the Board rejected the plan as too complex. "The issue has been on the back burner since then." AM. BANKER, Aug. 11, 1980, at 3. A modified 1980 proposal by the Banker's Association for Foreign Trade is still under study which would allow an Edge Corporation to "bank" specific types of internationally oriented companies, such as "export management companies, DISC's, and Webb-Pomerene associations." Lenhardt, *Continued Role for Edge Act Corps Seen*, AM. BANKER, April 30, 1981.

<sup>128</sup>46 Fed. Reg. 19,827 (April 1, 1981); 46 Fed. Reg. 48,221 (Oct. 1, 1981); 47 Fed. Reg. 13,832 (April 1, 1982).

"hot" issue. Regional banks,<sup>129</sup> on the one hand are fearful of a resulting introduction of undue competition, even for domestic business, especially when coupled with the new Edge Corporation branching powers; larger money-center banks, on the other hand, are supporting the concept, welcoming this significant increase in the Edge Corporation's potential customer base without the requirement of having to justify each individual transaction as being international, and anticipating the promotion of U.S. exports.<sup>130</sup>

### *International Banking Facilities*

Another Board proposal that has implications for Edge Corporations, and is equally applicable to all domestic branches and agencies of foreign banks and to all foreign-owned national and state-chartered banks, relates to international banking facilities ["IBFs"].<sup>131</sup> These facilities are able to book transactions with foreign customers free of the domestic reserve requirements and interest rate ceilings which have led many domestic banks to conduct their international banking from branches in foreign countries. It is expected that removal of restraints will lower costs of conducting these activities at domestic offices and thus bring this business back to the United States.

With respect to nonbank customers<sup>132</sup> located outside the United States, IBFs may accept only deposits that support the customer's operations outside the United States and may extend credit only to finance the customer's non-U.S. operations. An Edge Corporation is not required to establish a separate organizational structure for an IBF but rather it would be operated primarily as a recordkeeping entity. Although IBFs could be established anywhere in the country, they should be especially attractive to out-of-New York State banks that desire to conduct Eurodollar activity in New York City.

After much consideration since July 1978, the Board approved this proposal, effective December 3, 1981.<sup>133</sup> However, in approving the plan, the Board has tried to weave a regulatory web to prevent utilization of the facil-

<sup>129</sup>See Foorman, *supra* note 50, at 49, n.43; Battey, *International Banking Issues High on Fed. Agenda*, AM. BANKER, Aug. 11, 1980, at 3.

<sup>130</sup>See Cobb, *supra* note 105, at 243-244; Miossi, *Foreign Banks at Home in the U.S.*, 1 U. ILL. L. FORUM 33, 39 (1980). See also Rosenstein, *Hearing Reveals Banking Split Over Edge Corp. Powers*, AM. BANKER, July 23, 1979, at 3.

<sup>131</sup>Houpt, *Outlook for Edges Remains Bright But Changes in McFadden Could Lessen Their Appeal*, AM. BANKER, April 30, 1981.

<sup>132</sup>This includes foreign governments, corporations, individuals and subsidiaries of U.S. companies only. However, an IBF may still obtain funds from foreign offices of other U.S. depository institutions, foreign banks, other IBFs, and the institution that establishes the IBF, and extend credit to other IBFs or to U.S. and non-U.S. offices of the depository institution establishing the IBF.

<sup>133</sup>See 46 Fed. Reg. 32,426 (June 23, 1981) (amending Regulations D and Q). Battey, *Fed. Approves International Banking Facilities Free of Reserve Requirements, Rate Ceilings*, AM. BANKER, June 10, 1981.

ities to circumvent the reserve requirements for domestic business. Foreign currency transactions are expressly allowed, and activities are limited only by the prohibitions listed in the rules. Supervision of an IBF will be conducted in conjunction with examination of other operations of the institution establishing the IBF.<sup>134</sup> As a result of this innovation, the role of offshore banking centers is expected to shrink considerably.<sup>135</sup>

### *Export Trading Companies*

Finally, in the Export Trading Company Act of 1982, (the ETC Act), which became effective on October 8, 1982, Congress has created further opportunities for investment by Edge Corporations.<sup>136</sup> This act amends Section 4(c) of the Bank Holding Company Act to allow bank holding companies,<sup>137</sup> Edge Corporations which are subsidiaries of bank holding companies, and "bankers' banks",<sup>138</sup> to invest in, control and actively participate in export trading companies (ETCs) (i.e., companies which are exclusively engaged in activities related to international trade and which are organized and operated principally for the purpose of exporting goods or services produced in the United States by providing one or more export services).

ETCs are companies which can provide a full range of trade services.<sup>139</sup>

<sup>134</sup>While some of these deposits would be subject to federal insurance requirements, an Edge Corporation IBF would still be exempt from the control of the FDIC.

<sup>135</sup>Edge Corporations had established 27 IBFs by year-end 1981, including seven of the eight largest ones in Miami. Assets that were held in the offshore branches of many of their parent banks are apparently coming back on shore via their Edge Corporation subsidiaries. See Cacace, *supra* note 39; Rowe, *Offshore Bank's Role Expected to Shrink*, WASHINGTON POST, Dec. 3, 1981 (attraction is lower cost [because risk of placing funds in United States is lower] as well as greater management control). See also Kahana, *Free Banking Zones Attracting More Business From Abroad*, AM. BANKER, Mar. 26, 1982, at 22.

<sup>136</sup>See Yingling and Hill, *New Export Trading Company Act Presents Investment Opportunity for Banking Firms*, AM. BANKER, Oct. 21, 1982, at 4; Rosenstein, *Congress Allows Banking Companies to Invest in Export Firms*, AM. BANKER, Oct. 5, 1982, at 1.

<sup>137</sup>Codified at 12 U.S.C. § 1843(c)(14). Throughout its consideration of the banking provisions of this legislation, Congress was attempting to balance the conflicting policy issues inherent in (1) the long-standing policy of separating bank deposit-taking and commercial activities and (2) the belief that bank participation was critical to the successful expansion of U.S. export trade due to their resources, contacts and experience. Yingling and Hill, *supra* note 136. The final language limiting direct bank equity investment attempts to ensure that bank control and management of ETCs would not unacceptably increase the financial risk to investing banks. In particular, Mr. R. T. McNamara, Deputy Secretary of the Treasury, noted that the Administration would not support the investment by Edge Corporations in ETCs unless the Edge Corporation was a subsidiary of a bank holding company, as otherwise the investment would "place the bank owning the Edge . . . directly at risk in the highly competitive export trading business." McCue, *State Supervisors Hit Export Bill*, AM. BANKER, May 26, 1982.

<sup>138</sup>The term "bankers' banks" describes those banks which serve other banks. Rosenstein, *supra* note 136.

<sup>139</sup>These include: documentation, transportation, financing, taking title to goods, warehousing, marketing, consulting, international market research, advertising, insurance (with limitations), product research and design, legal assistance and communication and processing of foreign orders to and for exporters and foreign purchasers. 4 EAST ASIAN EXECUTIVE REPORTS 17, Feb. 15, 1982.

ETCs generally act as intermediaries for manufacturing companies by taking title to goods or by handling the purchase or sale of goods abroad on a commission basis, and serve to diversify and absorb the risks associated with international trade. While some U.S. ETCs are already in existence, they have not developed as extensively as in most European countries, Japan and Korea which have large-scale, general purpose trading companies.<sup>140</sup>

Pursuant to the ETC Act, bank holding companies and subsidiary Edge Corporations will now be able to participate in ETCs not only as a lender but also as an equity investor. Edge Corporations which invest in ETCs will be able to provide financing, information and advice, documentary services, foreign exchange facilities and services in conjunction with the ETC's marketing activities.<sup>141</sup> The ETC Act encourages investing organizations to engage in joint ventures, partnerships or other cooperative arrangements with other authorized banking organizations of nonbanking firms to organize an ETC<sup>142</sup> in order to bring together foreign trade expertise and financing services in one corporate entity.

Equity investments by bank holding companies and subsidiary Edge Corporations in ETCs are limited to 5 percent of the investing organizations consolidated capital and surplus (25 percent in the case of an investment Edge Corporation). In addition, credit may be extended to the ETC in an amount not to exceed 10 percent of the investing organization's consolidated capital and surplus. Such loans to the ETC may not be on terms more favorable than those extended to similar borrowers and may not involve more than the normal risk of repayment.

The ETC Act contains three express prohibitions on activities of ETCs: (1) no securities activities are permissible other than those permissible for a bank holding company; (2) no agricultural production for a bank holding company; (3) no manufacturing is permitted, except for those incidental to product modification, reassembling, or the extracting of by-products if necessary to enable United States goods or services to conform with foreign requirements. The Board may also impose special conditions or require the divestment of an ETC if it determines that the ETC has been speculating in commodities, securities, or foreign exchange.

Under the procedures established by the ETC Act, an Edge Corporation must provide the Board with notice 60 days prior to its proposed investment in an ETC. If the Board does not take action to disapprove the investment within the review period, the investment may be undertaken. Disapproval

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<sup>140</sup>The law prior to the ETC Act did not preclude the formation of ETCs, however, they have been slow to develop due to banking regulations (which only allowed bank holding companies to own 5 percent of the stock of an ETC) and to uncertainties in the antitrust laws. 40 CONG. QUART. 1667, July 10, 1982; Battey, *Senate Passes Export Trading Subsidiary Bill*, AM. BANKER, April 10, 1981.

<sup>141</sup>See Allison, *supra* note 39.

<sup>142</sup>See Statement of Committee of Conference, Conf. Rep. No. 97-924; Yingling and Hill, *supra* note 136.



may be based only on the following criteria: (1) the necessity to prevent: (a) unsafe or unsound banking practices; (b) undue concentration of resources; or (c) decreased or unfair competition or conflicts of interests; (2) the failure to provide required information to the Board; or (3) a finding that the investment would affect the financial and managerial resources of the holding company such as to have a material adverse effect on the safety and soundness of a subsidiary bank. However, if the Board gives written notice of its intent not to disapprove a proposed investment, the investment may be made prior to the expiration of the 60-day period.<sup>143</sup>

### Conclusion

In conclusion, it is clear that as limitations have been and continue to be progressively liberalized, the outlook for Edge Corporations is bright. Assuming that interstate branching barriers are eventually lifted, those foreign banks with established Edge Corporation branches will certainly be in a more favorable position to take advantage of new geographic banking powers.<sup>144</sup> Although the advantages of Edge Corporations have not been fully recognized by foreign institutions, Edge Corporations will nevertheless continue to be a vital component of the international banking industry and should be given significant consideration by foreign banks seeking to penetrate or expand in the U.S. market.

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<sup>143</sup>See Yingling and Hill, *supra* note 136.

<sup>144</sup>See Alessandrini, *Foreign Bank Growth in U.S. Surpassing Expectations*, AM. BANKER, Mar. 26, 1982, at 15; Houpt, *Performance and Characteristics of Edge Corporations*, FEDERAL RESERVE SYSTEM REPORT, January 1981 at 46; Richter, *supra* note 45.

**Appendix****Edge Corporations Owned by Foreign Banks**

Location of Edge Corporation	Location of Branches	Name of Parent	Date Opened for Business
<b>MIAMI</b>			
Banco de Bogota International Corp.	None	Banco de Bogota Columbia	9-15-80
Banco de Santander International, Inc.	None	Banco de Santander Spain	2-19-80
Banco De Venezuela International	New York	Banco de Venezuela, Caracas	7-81
Bank of Tokyo International U.S.A.	None	Bank of Tokyo	10-82
European American Bank International	Los Angeles	European Amer. B & T Co., New York <sup>(a)</sup>	7-2-81
Marine Midland Interamerican Bank	Los Angeles, Houston & Cayman Islands	Hongkong & Shanghai Banking Corp., Hong Kong	5-29-79
J. Henry Schroder International Bank	None	J. Henry Schroder B & T Co., New York <sup>(a)</sup>	2-13-81
Union Chelsea International Banking Corp.	Cayman Islands	Banco Union, Caracas Venezuela	11-2-81
<b>CHICAGO</b>			
ABN Bank International USA	Miami & Houston	Algemene Bank, Nederland, Amsterdam	12-1-80
Banco Real International, Inc.	Houston	Banco Real, Sao Paulo, Brazil	6-1-81
<b>NEW YORK</b>			
Banco Cafetero International Corp.	None	Banco Cafetero, Bogota, Colombia	2-26-82
Consolidado International Bank	New York <sup>(b)</sup>	Banco Consolidado, Caracas, Venezuela	6-81

Crocker Bank International	Chicago	Midland Bank Group, London	8-4-67
Skandinaviska Enskilda Banken International Corp.	Cayman Islands	Skandinaviska Enskilda Banken, Stockholm, Sweden	5-18-81

## HOUSTON

Banq. de Paris et des Pays-Bas Int'l (Houston) Co.	None	Compagnie Financiere de Paris et des Pays- Bas <sup>(c)</sup>	12-4-79
Barclays Bank International Ltd.	None	Barclays Bank, Ltd, London	9-81
Standard Chartered International	None	Chartered Bank Ltd., London	1-1-82
Comind International Banking Corp.	None	Banco de Comercio e Industria de Sao Paolo, S.A.	5-3-82
Hongkong Bank International	None	Hongkong & Shanghai Banking Corp., Hong Kong	5-18-82

## SAN FRANCISCO

Fuji Bank International Corp.	None	Fuji Bank	11-82 <sup>(d)</sup>
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<sup>(a)</sup>Parent bank is owned, in turn, by a foreign bank, or banks.

<sup>(b)</sup>Applied to Federal Reserve Board to establish branch in Oct. 1981.

<sup>(c)</sup>Holding company for Banque de Paris et des Pay-Bas.

<sup>(d)</sup>Expected.

Source: Am. Banker, March 26, 1982, at 61; conversation with Federal Reserve Bank of New York, August 3, 1982; and *Jiji Press Ticker Service*, Oct. 4, 1982.

Foreign-owned banks established seven of the 16 new Edge Corporations last year. In 1979, there were only two foreign-owned Edge Corporations. In 1980, the number grew to nine, and in 1981 it rose to 16. There are presently 68 Edge Corporations, 88 domestic branches, and 18 foreign branches. See Cacace, *supra* note 39.

